

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200747001**

Release Date: 11/23/2007

Index Number: 170.12-02, 674.00-00,
2035.00-00, 2511.03-00,
2512.16-04, 4943.00-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-106511-07

Date:
August 3, 2007

| | |
|-------------------------|---|
| Husband | = |
| Wife | = |
| Trust | = |
| Corporation | = |
| State | = |
| <u>X</u> | = |
| Charitable Organization | = |
| Trustee | = |
| Law Firm | = |
| Individual | = |

Dear :

This is in response to your representative's letter dated January 26, 2007, requesting a ruling on the income, estate, gift, and excise tax consequences of the creation of a charitable lead annuity trust.

FACTS

The facts and representations submitted are summarized as follows: Husband and Wife propose to create Trust, an irrevocable trust intended to qualify as a charitable lead annuity trust described in § 2522(c)(2)(B) of the Internal Revenue Code ("Code"). On Trust's creation, Husband and Wife each will transfer voting common stock of

Corporation, a State corporation that has elected to be taxed as a subchapter S corporation within the meaning of § 1361.

Under the terms of Trust, as proposed, the trustee will pay (in cash, in kind, or partly in each) an annuity amount equal to x percent of the initial net fair market value of the trust assets to Charitable Organization, an organization described in §§ 170(b)(1)(A), 2055(a), and 2522(a) of the Code. If Charitable Organization is not an organization described in §§ 170(b)(1)(A), 2055(a), and 2522(a) at the time any portion of the annuity amount is payable to it, the trustee will distribute such portion to one or more organizations described in §§ 170(b)(1)(A), 2055(a), and 2522(a), as the trustee will select.

Trustee is a nonadverse party within the meaning of § 672(b). The trust agreement, as proposed, provides that if the trustee dies or becomes unable or unwilling to serve, a successor trustee who is a nonadverse party within the meaning of § 672(b), and who is not related or subordinate to Husband and Wife within the meaning of § 672(c), will be appointed by the Management Committee of Law Firm. Husband and Wife are prohibited from serving as the trustee.

As proposed, Trust will end on the earlier of the expiration of a five year period or upon the death of the second to die of Husband and Wife. The trust agreement provides that upon termination of Trust, the trustee may distribute Trust's assets to one or more organizations described in §§ 170(b)(1)(A), 2055(a), and 2522(a), to be selected by the trustee in such amounts and proportions as the trustee shall determine, in the trustee's sole discretion. All of the assets of Trust remaining after any distribution will be distributed outright to the then living issue of Husband and Wife, by right of representation; provided, however, that assets distributable to a grandchild of Husband and Wife who has not attained the age of thirty years will instead be held in a separate trust for the benefit of the grandchild.

In addition to provisions outlined above, the trust agreement contains the following relevant provisions:

Article 3(C)(1) provides that the annuity amount will be paid in annual installments at the end of each taxable year.

Article 3(C)(3)(c) provides that during the term of Trust, no amount may be paid to or for the use of any person other than an organization described in §§ 170(b)(1)(A), 2055(a), and 2522(a), unless the amount is paid for full consideration.

Article 3(C)(4) provides that the annuity amount will be prorated for short taxable years.

Article 3(D) provides that no additional contributions may be made to the trust after the initial contribution.

Article 3(F) provides that Individual will have the power, exercisable in a nonfiduciary capacity, to acquire assets of the trust by substituting other assets of equivalent value. Individual is a nonadverse party within the meaning of § 672(b). Exercise of the power is to be evidenced by a written instrument delivered to the trustee and is to include Individual's certification that the substituted property is of equivalent value to the property for which it was substituted. The trustee may independently verify such certification of value and any dispute as to the value of the acquired or substituted assets will be resolved in an appropriate judicial forum. If Individual dies or becomes incapacitated during the term of Trust, the Management Committee of Law Firm will designate another person who is a nonadverse party within the meaning of § 672(b) to hold this power, in a nonfiduciary capacity.

Article 3(G) provides that if the initial net fair market value is incorrectly determined, then within a reasonable period after the final determination of the correct value, the trustee will pay to the charitable beneficiary in the case of an undervaluation, or will receive from the charitable beneficiary in the case of an overvaluation, an amount equal to the difference between the amount properly payable and the amount actually paid.

Article 3(I) provides that the trustee is prohibited from engaging in any act of self-dealing as defined in § 4941(d), from retaining any excess business holdings as defined in § 4943(c) that would subject Trust to tax under § 4943, from making any investments that would subject Trust to tax under § 4944, and from making any taxable expenditures as defined in § 4945(d). If § 4942 is deemed applicable to Trust by reason of § 508(e) or otherwise, Trustee will make distributions at such time and in such manner as not to subject Trust to tax under § 4942.

Article 3(J) provides that the trustee will have the power to amend Trust for the sole purpose of complying with the requirements of § 170(f)(2)(B), § 2055(e)(2)(B), or § 2522(c)(2)(B) and the regulations thereunder.

Article 3(K) provides that Trust will be governed and administered under the laws of State.

Article 3(M) provides that no federal estate taxes, state death taxes or any other estate, death or inheritance taxes will be allocated to or recoverable from Trust.

You have requested the following rulings:

1. The funding of Trust will be a completed gift for federal gift tax purposes.
2. The annuity payable under the trust agreement will qualify as a guaranteed annuity under § 2522(c)(2)(B).
3. Husband and Wife will be entitled to federal gift tax charitable deductions under § 2522 for the present value of the annuity payments from Trust, to be

- allocated between Husband and Wife in proportion to their reported gifts to Trust.
4. No portion of Trust will be includible in Husband and/or Wife's gross estates for federal estate tax purposes.
 5. Trust will be an eligible shareholder of Corporation for purposes of Corporation's status as a subchapter S corporation.
 6. Husband and Wife will be entitled to a federal income tax charitable deduction under § 170(a) for the value of the charitable annuity interest at the date of contribution.
 7. Trust will not have excess business holdings and will not be subject to excise tax under § 4943.

Rulings 1 through 3

Section 2501 provides that a tax, computed as provided in § 2502, is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511(a) provides, in part, that subject to limitations contained in chapter 12, the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) of the Gift Tax Regulations provides that as to any property, or part thereof, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for the donor's own benefit or for the benefit of another, the gift is complete.

Section 25.2511-2(c) provides, in part, that a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves.

Section 2522(a) provides that, in computing an individual's taxable gifts for the calendar year, a deduction shall be allowed for the amount of all gifts to or for the use of certain governmental entities, certain corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, and certain other fraternal organizations.

Section 2522(c)(2) provides that where a donor transfers an interest in property (other than an interest described in § 170(f)(3)(B)) to a person, or for a use, described in § 2522(a) or (b) and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than an adequate and full consideration in

money or money's worth) from the donor to a person, or for a use, not described in § 2522(a) or (b), no deduction is allowed for the interest that is, or has been transferred to the person, or for the use, described in § 2522(a) or (b), unless—

- (A) in the case of a remainder interest, the interest is in a trust that is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)), or
- (B) in the case of any other interest, the interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly).

Section 25.2522(c)-3(a) provides that if a trust is created or property is transferred for both a charitable and a private purpose, a deduction may be taken for the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

Section 25.2522(c)-3(c)(2)(vi)(a) provides that a deductible interest is a charitable interest in property only where the charitable interest is a guaranteed annuity, whether or not the interest is in trust. For purposes of § 25.2522(c)-3(2)(vi), the term “guaranteed annuity” means an irrevocable right pursuant to the instrument of transfer to receive a guaranteed annuity. A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years or for the life or lives of a named individual or individuals each of whom must be living at the date of the gift and can be ascertained at that date. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer is ascertainable as of the date of the gift. For example, the amount to be paid may be a stated sum for a term, or for the life of an individual, at the expiration of which it may be changed by a specified amount, but it may not be redetermined by reference to a fluctuating index such as the cost of living index. In further illustration, the amount to be paid may be expressed as a fraction or percentage of the cost of living index on the date of the gift.

Section 25.2522(c)-3(c)(2)(vi)(b) provides that a charitable interest is a guaranteed annuity interest but only if it is a guaranteed annuity interest in every respect. For example, if the charitable interest is the right to receive from a trust each year a payment equal to the lesser of a sum certain or a fixed percentage of the net fair market value of the trust assets, determined annually, the interest is not a guaranteed annuity interest.

Section 25.2522(c)-3(c)(2)(vi)(e) provides that where a charitable interest in the form of a guaranteed annuity interest is in trust and the present value of all income interests for charitable purposes exceeds 60 percent of the aggregate fair market value of all amounts in the trust (after payment of liabilities), the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust

prohibits both the acquisition and retention of the assets which would give rise to a tax under § 4944 if the trust acquired such assets.

In the instant case, we conclude that the transfers of Corporation stock to be made by Husband and Wife to Trust will constitute completed gifts under § 25.2511-2(b) because Trust will be irrevocable and Husband and Wife will have retained no interest or reversion in Trust.

Under the proposed Trust agreement, a qualified charitable organization or organizations are given the irrevocable right to receive a fixed percentage of x percent of the initial net fair market value of Trust's assets. The charitable lead annuity trust will terminate on the earlier of the expiration of a five year period or upon the death of the second to die of Husband and Wife. When the annuity interest terminates, the interest will have continued for a term of years or for the lives of Husband and Wife who, as donors, will be lives in being on the date Trust is created. Accordingly, the amount paid will be a determinable amount and the annuity interest will meet the definition of a guaranteed annuity interest described in § 25.2522(c)-3(c)(2)(vi). See Rev. Rul. 85-49, 1985-1 C.B. 328.

Based on the representations made and provided that the charitable lead annuity trust is established and administered under the proposed trust agreement, as submitted, and further provided that the charitable lead annuity trust will be a valid trust under state law, we conclude that the annuity payable under the terms of the proposed trust will be a guaranteed annuity interest within the meaning of § 2522(c)(2)(B) and § 25.2522(c)-3(c)(2)(vi). Accordingly, we conclude that the transfers by Husband and Wife will qualify for gift tax charitable deductions under § 2522(a).

Under § 25.2522(c)-3(d)(2)(iv), the amount of the deduction is the present value of the annuity interest determined in accordance with § 25.2512-5 and § 25.7520-1.

Ruling 4

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of the decedent's death.

Section 2035(a) provides that if (1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under § 2036, § 2037, § 2038, or § 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of the decedent's death, then the value of the gross estate shall include the value of any property (or interest therein) that would have been so included.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for life or for any period not ascertainable without reference to the decedent's death or for any period which does not in fact end before the decedent's death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 20.2036-1(a) of the Estate Tax Regulations, provides, in part, that for purposes of § 2036, an interest or right is treated as having been retained or reserved by the decedent if at the time of the transfer there was an understanding, express or implied, that the interest or right would later be conferred.

Section 2037(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property and the value of such reversionary interest immediately before the death of the decedent exceeds five percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of the decedent's death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person to alter, amend, revoke, or terminate, or where any such power is relinquished during the three year period ending on the date of the decedent's death.

Section 2042(2) provides that the value of the gross estate shall be the value of all property to the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.

In the present case, Trust is irrevocable. For the shorter of a five year period or the lives of Husband and Wife, Trustee must distribute annually a fixed annuity amount of x

percent of the initial net fair market value of the trust assets to an organization described in §§ 170(b)(1)(A), 2055(a), and 2522(a). Upon the termination of the annuity period, some or all of Trust's assets may pass, in the trustee's sole discretion, to one or more organizations described in §§ 170(b)(1)(A), 2055(a), and 2522(a), and any remaining property in Trust will pass to the then living issue of Husband and Wife, by right of representation. Husband and Wife have not retained any (i) interest or reversion in Trust, (ii) any right to alter, amend, or revoke Trust, or (iii) any right to receive an annuity or other payment from Trust during their lifetimes.

Under these circumstances, we conclude that no portion of the value of the assets of Trust will be included in the gross estate of Husband or Wife under § 2036, § 2037, § 2038, or § 2042 for federal estate tax purposes. We further conclude that because no portion of the value of the assets transferred by Husband and Wife to Trust will be includible in his or her respective gross estate under § 2036, § 2037, § 2038 or § 2042, no portion of the value of the assets transferred by Husband and Wife to Trust will be includible in his or her respective gross estate under § 2035.

Ruling 5

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

Section 1361(c)(1)(A) provides that for purposes of § 1361(b)(1)(A), there shall be treated as one shareholder a husband and wife (and their estates).

Section 1.1361-1(e)(2) provides that for purposes of determining the number of shareholders, stock owned by a husband and wife (or by either or both of their estates) is treated as if owned by one shareholder, regardless of the form in which they own the stock. For example, if husband and wife are owners of a subpart E trust, they will be treated as one individual.

Section 1361(c)(2)(B)(i) provides that, for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 671 provides that where the grantor or another person is treated as the owner of any portion of a trust, there shall be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Sections 673 through 677 specify the circumstances under which the grantor is regarded as the owner of a portion of a trust.

Section 674(a) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 672(a) provides that an adverse party is any person having a substantial beneficial interest in a trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust.

Section 672(b) provides that a nonadverse party is any person who is not an adverse party.

Section 1.672(a)-1(a) of the Income Tax Regulations provides that an adverse party is defined as any person having a substantial beneficial interest in a trust which would be adversely affected by the exercise or nonexercise of a power which he possesses respecting the trust. A trustee is not an adverse party merely because of his interest as trustee. An interest is substantial if its value in relation to the total value of the property subject to the power is not insignificant.

Section 674(b)(4) exempts from § 674(a) a power to determine the beneficial enjoyment of the corpus or the income therefrom if the corpus or income is irrevocably payable for a purpose specified in section 170(c) (relating to the definition of charitable contributions).

Section 674(c) exempts from § 674(a) a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor. These powers include the powers to distribute, apportion, or accumulate income to or for beneficiaries or a class of beneficiaries, and the power to pay out corpus to or for beneficiaries or a class of beneficiaries. A power does not fall

within the powers described in § 674(c) if any person has a power to add to the beneficiaries or a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

Section 674(b)(2) exempts from § 674(a) a power, the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that a grantor would not be treated as the owner under § 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the occurrence of the event unless the power is relinquished.

Section 1.671-3(b)(3) provides, in part, that a grantor includes both ordinary income and other income allocable to corpus in the portion the grantor is treated as owning if the grantor is treated under § 674 or § 676 as an owner because of a power over corpus which can affect income received within a period such that the grantor would be treated as an owner under § 673 if the power were a reversionary interest.

Section 673(a) provides that the grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds five percent of the value of such portion.

Under the terms of Trust, the trustee may distribute Trust assets remaining at the end of the trust term to one or more charitable beneficiaries to be selected by the trustee. The trustee's power to select charitable beneficiaries to receive Trust assets remaining at the end of the trust term is a power of disposition over this portion of the trust exercisable by a nonadverse party under § 674(a). This power of disposition over the assets remaining at the end of the trust term would cause Husband and Wife to be treated as owners of the entire trust under § 674 assuming Husband and Wife would be treated as owners under § 673 if the power were a reversionary interest. Section 674(b)(2) and § 1.671-3(b)(3). Husband and Wife would be treated as owners under § 673 if the power were a reversionary interest in the event that the present value of the assets remaining at the end of the trust term exceeds five percent of the value of the amount contributed to the trust.

Based on the applicable federal rate of .062 for the month of August 2007, the present value of the trust assets remaining at the end of the trust term would exceed five percent of the value of the amount contributed to Trust. To take advantage of the calculation using the August 2007 applicable federal rate, the trust may be funded in this month or may be funded in the following two months if the appropriate election is made under § 1.7520-2(b)(2). If the trust is not funded in the month of August 2007 or funded in the following two months if the appropriate election is made under § 1.7520-2(b)(2), then the ruling is subject to the condition that Husband and Wife have an annuity amount (based on the § 7520 calculation) such that the present value of the

assets remaining at the end of the trust term is greater than five percent of the amount contributed to the trust.

Assuming that Trust meets the five percent test, we conclude that Husband and Wife will be treated as the owners of Trust under § 674. Accordingly, during the lives of Husband and Wife, Trust will be a permitted shareholder of the S corporation under § 1361(c)(2)(A)(i).

Ruling 6

Section 170(a)(1) provides that there is allowed as a deduction any charitable contribution (as defined in § 170(c)) payment of which is made within the taxable year.

Section 170(c) defines a charitable contribution as a contribution or gift to or for the use of a qualified charity.

Section 170(f)(2)(B) provides that no charitable contribution deduction is allowed for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of the interest for purposes of applying § 671.

Section 1.170A-1(c)(1) of the Income Tax Regulations provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in § 170(e)(1) and § 1.170A-4(a), or § 170(e)(3) and § 1.170A-4A(c).

Section 1.170A-6(c) states that no deduction is allowed under § 170 for the fair market value of a charitable contribution of an income interest in property that is less than the donor's entire interest in the property and that the donor transfers in trust unless the income interest is either a guaranteed annuity or a unitrust interest.

Section 1.170A-6(c)(2)(i)(A) treats an income interest as a "guaranteed annuity interest" only if it is an irrevocable right pursuant to the governing instrument of the trust to receive a guaranteed annuity. This regulation provides that a guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term or for the life or lives of an individual or individuals. An amount is determinable if the exact amount which must be paid under the conditions specified in the governing instrument of the trust can be ascertained as of the date of transfer.

Section 1.170A-6(c)(3)(i) provides that the deduction allowed by § 170(f)(2)(B) for a charitable contribution of a guaranteed annuity interest is limited to the fair market value

of such interest on the date of contribution, as computed under § 20.2031-7 or, for certain prior periods, § 20.2031-7A.

With exceptions not relevant here, § 1.170A-6(c)(2)(i)(E) provides, in general, that an income interest consisting of an annuity transferred in trust after May 21, 1972, will not be considered a guaranteed annuity interest if any amount other than an amount in payment of the guaranteed annuity interest may be paid by the trust for a private purpose before the expiration of all the income interests for a charitable purpose.

Article 3(C)(3)(c) of the trust agreement provides that the trustee is prohibited from paying any amount to or for the use of any person other than an organization described in §§ 170(b)(1)(A), 2055(a), and 2522(a) prior to the termination date of the trust. Payments that do not comply with § 1.170A-6(c)(2)(i)(E) are prohibited during the term of the trust.

In order to qualify as a guaranteed annuity interest, the governing instrument must meet certain requirements. See § 1.170A-6(c). Under §§ 4947(a)(2) and 508(e), with certain exceptions in § 4947(b)(3), the governing instrument of a charitable lead annuity trust must include provisions the effects of which are to prohibit the trust from engaging in any act of self-dealing (as defined in § 4941(d)), from retaining any excess business holdings (as defined in § 4943(c)), from making any investments in such manner as to subject the trust to tax under § 4944, and from making any taxable expenditures (as defined in § 4945(d)).

Article 3(I) of the trust agreement provides that the trustee is prohibited from acquiring, making, or retaining any investments in such a manner as to subject the trust to tax under § 4944.

During the term of Trust, pursuant to Article 3(C) of the trust, the trustee will in each taxable year of the trust pay to one or more organizations then described in §§ 170(b)(1)(A), 2055(a), and 2522(a) an amount equal to x percent of the initial net fair market value of the trust property. No payments to any other recipients will be permitted during the term of the charitable annuity interest. Thus, a qualified charity will have an irrevocable right to receive the annuity amount each year during the term of the trust.

Section 4947(b)(3)(A) and § 53.4947-2(b) provide, however, that §§ 4943 and 4944 do not apply to a trust if: (i) all of the income interest (and none of the remainder interest) of the trust is devoted solely to a charitable purpose; and (ii) all amounts in such trust for which a deduction was allowed have an aggregate value of not more than 60 percent of the aggregate fair market value of all amounts in such trust.

Section 1.170A-6(c)(2)(i)(D) provides that if the present value on the date of transfer of all the income interests for a charitable purpose exceeds 60 percent of the aggregate

fair market value of all amounts in the trust (after the payment of liabilities), the income interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits both the acquisition and retention of assets which would give rise to a tax under § 4944 if the trustee had acquired such assets.

The value of the charitable annuity in this case exceeds 60 percent of the value of the assets of Trust, and, therefore, the exceptions provided in § 4947(b)(3)(A) do not apply. The terms of the trust agreement, however, prevent Trust from being subject to payment of tax under § 4944. Thus, the provisions of the trust satisfy the requirements of § 1.170A-6(c)(2)(i)(D) and (F).

Trust will be a grantor trust, and Husband and Wife will be treated as the owners of Trust for purposes of applying § 671 of the Code. As a result, the requirement of § 170(f)(2)(B) is satisfied.

Inasmuch as the trust meets the requirements of section 1.170A-6(c), and Husband and Wife are treated as the owners of Trust for purposes of § 671, the charitable interest is a guaranteed annuity interest for purposes of the income tax charitable contribution deduction under § 170(f)(2)(B). Husband and Wife will therefore be entitled to an income tax charitable contribution deduction under § 170(f)(2)(B) for the present value, on the date of the contribution, of the guaranteed annuity interest, subject to any applicable limitations of § 170, including §§ 170(b) and 170(e)(1), and subject to any applicable limitations under other sections of the Code.

Ruling 6

Section 509(a) provides that unless specifically excepted, a domestic or foreign organization described in § 501(c)(3) is a private foundation and subject to the excise taxes imposed by chapter 42.

Section 4947(a)(2) provides that certain split-interest trusts which are not exempt under § 501(a) and for which a charitable deduction was allowed are treated as private foundations and subject to the excise taxes imposed by chapter 42.

Section 4943(a)(1) imposes an excise tax on the excess business holdings of a private foundation in a business enterprise.

Section 4943(c)(1) defines the term “excess business holdings” as meaning with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise that the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

Section 4943(c)(2)(A) provides that “permitted holdings” of any private foundation in an incorporated business enterprise are defined as: (i) 20 percent of the voting stock, reduced by (ii) the percentage of the voting stock owned by all disqualified persons.

Section 4943(c)(6)(A) provides that, with certain exceptions not applicable here, if after May 26, 1969, there is a change in the holdings of a business enterprise (other than by purchase, i.e., by gift or bequest) by the private foundation or by a disqualified person that causes the private foundation to have excess business holdings in such enterprise, the interest of the foundation in such enterprise (immediately after such change) shall (while held by the foundation) be treated as held by a disqualified person (rather than by the foundation) during the five year period beginning on the date of such change in holdings.

Section 4946(a) defines a “disqualified person” as including a substantial contributor to the foundation and members of the family of the substantial contributor.

In Example 1 of § 53.4943-6(a)(3) of the Foundation and Similar Excise Tax Regulations, on January 4, 1985, A, an individual, makes a contribution to F, a private foundation, of 200 shares of X corporation common stock. Assume that F had no X stock before January 4, 1985, and under § 4943(c)(1) the receipt of the X stock by F would cause some or all of the 200 shares of the X stock to be classified as excess business holdings. Under the provisions of § 4943(c)(6)(A) and § 53.4943-6(a), since the contribution of the X stock to F is a gift and not a purchase, the X stock in F’s hands is treated as held by disqualified persons and not by F through January 3, 1990.

In the instant case, as a charitable lead annuity trust, Trust is a split-interest trust described in § 4947(a)(2) and is, therefore, subject to § 4943. Section 4943 imposes an excise tax on excess business holdings. Husband and Wife are disqualified persons with respect to Trust because they are substantial contributors to Trust.

Pursuant to § 4943(c)(2), Trust’s “permitted holdings” are defined as twenty percent of the voting stock of the business enterprise reduced by the percentage of voting stock owned by all disqualified persons. The facts provided indicate that Husband and Wife own more than twenty percent of the voting stock of Corporation. As such, the permitted holdings of Trust would be zero.

Under § 4943(c)(6), during the five year period beginning with the date on which Trust acquires stock of the corporation, the stock is deemed to be owned not by Trust, but rather by a disqualified person and the tax under § 4943 is inapplicable during the five year period. Under the terms of the trust agreement, Trust shall terminate at the earlier of five years after the creation of Trust or at the death of the second of die of Husband and Wife. Based on the foregoing, Trust will terminate before it is deemed to have excess business holdings and, therefore, the tax under § 4943 will not apply under these facts and circumstances.

Accordingly, we rule that because Trust terminates and any stock of Corporation held in Trust will be distributed by Trust no later than five years after the date the stock is contributed to Trust, Trust will not have excess business holdings and will not be subject to excise tax under § 4943.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James F. Hogan
Senior Technician Reviewer, Branch 4
(Passthroughs & Special Industries)